

**FINANCIAL INSTITUTIONS AND RURAL  
ECONOMIC DEVELOPMENT**

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I appreciate the invitation from Peter Skillern and his colleagues at CRA-NC to attend this conference and to speak with you about a topic that is important to the people of North Carolina: rural economic development and the role that financial institutions can play. Participation in this conference, including preparation of this talk, has given me an opportunity to delve into an issue with which I have some familiarity. This learning process has been aided by works of others, to whom I am profoundly grateful, including the North Carolina Rural Center, the University of North Carolina Center for Community Capitalism and, last but certainly not least, CRA-NC.

In approaching this topic, I would like to review with you (i) what exactly we are talking about when we talk about rural North Carolina, (ii) how North Carolina financial institutions are serving rural markets, (iii) what the inhibitors are or may be to more effective service by financial institutions to these markets, and (iv) some suggestions about how the stakeholders in this issue may address it in the future. While my talk will refer to the Community Reinvestment Act, it will seek to supplement the discussion of that statute that has taken place earlier today rather than repeating it.

### Defining Rural North Carolina

Based on its definition of a rural county as one that has a population density of less than 200 persons per square mile, the Rural Center includes 85 of North Carolina's 100 counties in the "rural" category. These counties contain a substantial majority of the land in North Carolina and over half its population (54% according to Census Bureau estimates for 1999). The corollary proposition to the last statement is, of course, that urban counties are home to nearly half the State's population but account for a small portion of the State's territory.

Given their large number and geographic variety, North Carolina's rural counties are a diverse aggregation about which generalizations are nearly impossible. The Rural Center has developed a Rural Economic Index through which North Carolina's rural counties are compared to rural counties in the Southeast and throughout the United States in respect of (i) *economic performance* (per capita income and employment) and (ii) *economic growth*. The conclusions from these comparisons are mixed. The good news is that during the period under study (1984-1993): (i) 82 of North Carolina's rural counties showed comparable or stronger economic performance and /or faster economic growth than comparable counties throughout the nation and in the Southeast; (ii) 84% of North Carolina's rural counties grew faster than rural counties throughout the United States; and (iii) 70% of our rural counties grew faster than rural counties in the Southeast. The "other news" from the Rural Economic Index is that, in terms of economic performance, over a third of North Carolina's rural counties did not perform as well as similar counties across the nation.

The economic information that I have just discussed confirms what I suspect most participants in this conference already know: that while economic development is important to all of North Carolina and to rural areas in particular, it is desperately needed in some of our rural counties. While I hope that the remainder of my talk will address the role of financial institutions in rural development generally, it will focus on rural counties with the greatest needs.

### Financial Services in Rural Counties

The availability of financial services is not the only factor affecting economic development in rural markets; it is, however, an important factor. Financial institutions perform an important intermediation function between savers and those in need of credit. Given the crucial role that capital plays in economic development, access to financial services is clearly a need of all communities and distressed communities in particular.

Assuming that bank branches are an appropriate proxy, the provision of financial services to rural markets varies, with discouraging trends at the economically distressed end of the spectrum. A recent study commissioned by CRA-NC reports that during the period 1996-2000 the number of bank branches declined in the thirty-six counties (all rural) comprising Tiers 1 and 2 under the William S. Lee Act, the two highest economic distress categories, while increasing in all other counties. At the same time, the number of check cashers in such counties expanded more rapidly in such counties than in other North Carolina counties. These findings are confirmed by studies at the UNC Center for Community Capitalism. The trends just mentioned occurred notwithstanding the fact that population in Tier 1 and 2 counties grew overall during the period in question, as did deposits.

As is the case with the Rural Economic Index, the inferences that can be drawn from the CRA-NC study just mentioned are mixed. Forty-nine rural counties are not included in Tiers 1 or 2 and, accordingly, experienced growth in bank branches that equaled or exceeded the State average. Furthermore, of the 19 counties listed as “critically underbanked” in the study (25% or more below the State average), only seven were included in Tiers 1 and 2. This last inference is at least muted by a cross-reference to the Rural Economic Index, which classifies 15 of the 19 underbanked counties as below average performers when compared to similar counties in the Southeast and around the country.

On balance, the CRA-NC study supports the inferences drawn previously from the Rural Economic Index. The counties in rural North Carolina vary in a number of ways, including economic performance and growth. While the presence of bank branches is not the only factor affecting economic performance and growth, there is a close enough correlation between low access to financial services and economic distress to make access to financial services a matter of importance in addressing the needs of our State’s poorest performing counties.

## Inhibitors to Growth of Rural Financial Services

Why have banks reduced their presence in distressed areas and non-bank firms increased? I would suggest three reasons that are separate but related. The first is the economics of retail financial services. The second is the cost imposed on banking organizations by regulation. The third has to do with the nature of rural communities. Let me discuss each of these factors in order.

Although they are impressed with a public interest, banking organizations are nonetheless private for-profit corporations. Those who engage in the retail banking business (which for purposes of this discussion includes small business lending) seek to maximize revenue by gathering deposits and lending. Because of the economic performance and growth characteristics of the markets in economic distress, it is probable that accounts and loans in such markets will be smaller, marginally riskier and no less labor intensive than larger accounts generated elsewhere. Combine these characteristics with low population density and it is hard to justify entry into such markets and easy to justify an exit. Non-bank financial institutions prosper in such markets by operating with a much lower cost structure and imposing fees and charges that are significantly greater than those of banking organizations.

Couldn't banks charge higher interest rates and fees to generate the profit necessary to make operation in rural markets more profitable? Theoretically yes, practically no. Because of their need to maintain at least satisfactory CRA and consumer compliance ratings, traditional banking organizations are hesitant to engage in differential risk- and cost-based pricing in the retail market. Most full service banking organizations with which I am familiar prefer to offer broad-based products with prices set on a "rate sheet" basis with the decision left to the originator being to lend or not. Monoline firms (e.g., credit card issuers) price on a more individualized basis, but such firms aren't as a rule involved in rural markets the way full-service firms are.

This is a loving criticism of the CRA, a statute that I believe has done a great deal of good for innumerable communities and the banking industry. I am not suggesting repeal or disregard of the statute; I am suggesting that we who support CRA ask ourselves whether its current application creates unintended disincentives to banking organizations expanding their activities in underserved markets, including rural markets.

The third and last of my inhibitors relates to culture. To the extent that banking organizations finance new economic development in rural communities, the residents may or may not be happy about such activity. While increasing local income, wealth and opportunity, new economic development may also bring traffic, crowding, pollution and other assorted urban ills. There is a school of thought in this country, including the Tar Heel State, that defends the importance of unspoiled nature and traditional life against the alleged depredations of modernity. To the extent that preservation of traditional life requires the financing of small-scale activities in agriculture or commerce, it increases the risk of lending and reduces return. I am not criticizing the ideas or actions of rural traditionalists, who have much to add to public discourse in North Carolina and

elsewhere. I am suggesting that if preservation of the rural way of life is a desirable public good, its cost should be born (or at least shared) by those promoting it.

### Addressing Rural Financial Services Needs in the Future

Am I arguing that financial institutions need do nothing more for rural communities, the distressed ones in particular? Of course not. The health of these communities is important as a social, cultural and economic matter. I am arguing that effectively meeting the needs of these communities requires some adjustments to the thinking of the stakeholders in rural economic development. Let me suggest a few.

*Cooperation Rather than Conflict.* I believe that success in addressing rural economic development depends on the coordinated efforts of government, community-based organizations and the private sector, including banking organizations. The effectiveness of each of these stakeholders is enhanced when augmented by the efforts of other stakeholders. North Carolina is blessed with a wide array of banking organizations and community groups that can and do work together toward the public good. Today's workshops are sterling examples of what such cooperation can achieve and how it can be fostered. I hope that these examples are harbingers of good things to come as we work in concert to serve those in need.

*Vision.* If compliance with the CRA has taught bankers anything over the last twenty-five years, it is the importance of appreciating cultural differences, including particularly differences in values that may characterize underserved financial markets. Rural markets are not monolithic and, accordingly, each will have a different development strategy based on its needs and values. For some communities, preservation of the agrarian way of life, with the attendant ecological and psychic benefits, may be the choice. For others, it may be the attraction of new businesses or the augmentation of existing businesses. These choices are the domain of local governments and community-based organizations. Financial institutions can contribute technical acumen and capital once the vision is agreed. Until then, effective contributions by such institutions are difficult, if not impossible.

*Incentives.* Regulators and community advocates would do well to review the ways we influence the flow of capital by increasing the costs and risks of expansion by banking organizations into underserved markets. We are very good at analyzing and criticizing the activities of banking organizations in markets they serve. Shouldn't we at least consider offering incentives to get them to go into underserved markets? Further, shouldn't we consider incentives to non-bank firms to increase activities that augment economic development?

*Rural Markets as Opportunities.* Bankers need to take off the blinders and look carefully at the opportunities that rural markets present. Operating safely and profitably is a difficult proposition in the best of times and these aren't the best of times. Disregarding financing opportunities in developing markets in the United States, including rural markets, is not good business. This conference has highlighted a number

of such opportunities. I hope very much that the bankers in the audience will give them a serious look.

### Concluding Remarks

To conclude, let me reemphasize several home truths. Rural North Carolina is a big piece of North Carolina. Addressing the economic and financial needs of rural North Carolina is important not only to the markets in question, but to our State as a whole. Doing so effectively will require the efforts of governments, non-profits and the private sector, including banking organizations. We have the technical competence and the knowledge; all that is needed now is imagination, energy and good will. The good news is, as this conference shows, that we have all of that too.

May I say again how much I appreciate being with you today. I look forward to working with you on this very important matter in the future.

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